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DATE SENT 8/24/70

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FROM - SEOUL

SUBJECT - Private Enterprise Development PROP

REFERENCE -

Attached is a non-capital project paper (PROP) covering project
489-15-930-677 Private Enterprise Development.

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AID AND OTHER CLEARANCES				
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Non-Capital Project Paper (PROP)

Country: Republic of Korea

Project No: 489-15-930-677

Submission Date:

Original X

Revision No. _____

Project Title: Private Enterprise Development

U.S. Obligation Span: FY 1971 through FY 1975

Physical Implementation Span: FY 1971 through FY 1976

Gross life-of-project financial requirements:

U.S. dollars: \$614,000

Cooperating country cash contribution: \$22,500,000

A. Summary Description

The Republic of Korea (ROK)'s continued development depends greatly upon the nation's success in fostering the growth of private enterprise and in attracting increased foreign private investment, especially ~~in~~ to the private sector. So far, Korea has been relatively successful in these areas, and has laid the groundwork for additional progress. Some improvement has been made recently in the investment climate and the ROK has shown that it is capable of attracting substantial investment. However, further assistance is needed to encourage continued private foreign equity investment in priority areas and to advise the Republic of Korea Government (ROKG) on more efficient investment analysis and procedures.

At the same time, there is a great need for the modernization of business practices and the money and capital markets in the ROK. Korea needs to improve its methods of management, production and marketing in business and industry in order to produce more goods of better quality and to be more competitive in the international market. In addition, Korean money/capital markets must be expanded and become more efficient so as to facilitate the access of private industry to local capital on longer terms than is now generally possible and at reasonable costs. The development of a capital market would permit better allocation of investment resources and increased responsiveness of capital to market mechanisms. In addition, an improved capital market would give the rapidly developing urban middle class an opportunity for equity investment in the growing economic prosperity and, in accord with Title IX of the Foreign Assistance Act, would have a welcome diffusing effect on the ownership of industry and business.

Under this proposed project AID will help the ROK establish improved investment procedures to attract increased amounts of private investment for the development of the key segments of the Korean economy. This project will also spur the growth of the private sector through the development of money and capital markets and by the further introduction of modern business practices through the Korea Productivity Center and other private business organizations. It is planned that this project will fund up to two direct hire advisors, three to four short-term institutional contract advisors and, up to fifteen participants per year, as well as limited commodities.

A summary of the overall financing of this project is attached hereto.

Non-Capital Project Funding

PROP Date:

Project No: 489-15-930-677

<u>Year</u>	<u>Direct Hire</u>	<u>Dollar Funding (\$000)</u>			<u>Com- modities</u>	<u>Other Costs</u>	<u>Total</u>
		<u>PASA</u>	<u>Contract Services</u>	<u>Participants</u>			
Prior thru FY 1970	--	-	-	-	-	-	-
FY 1971	36	-	25	32	-	-	93
FY 1972	75	-	20	53	-	-	148
FY 1973	76	-	16	49	-	-	141
FY 1974	78	-	12	45			135
FY 1975	<u>33</u>	-	<u>8</u>	<u>51</u>	<u>5</u>	-	<u>97</u>
Total:	298		81	230	5		614

Local Currency Funding (\$000)

<u>Year</u>	
Prior thru 1970	-
1971	5,000
1972	5,500
1973	4,500
1974	4,000
1975	<u>3,500</u>
Total:	22,500

In addition, it is anticipated that the ROKG will provide additional mon from its budget to help support activities related to this project.

B. Setting/Environment

The Republic of Korea (ROK) has made great strides in recent years along the path of economic development. In 1969 alone, the GNP rate of growth increased 15.6 percent, industrial production and exports continued to rise, and the level of annual per capita income reached a new high of \$195. Much of this rapid development has been due to an improved investment climate in Korea which has led to an influx of foreign private investment in the ROK. For example, almost \$50 million in equity was invested in Korea in 1969 by private foreign enterprises, while numerous other investments were made in the form of private and government loans and credits.

In contributing to the ROK's economic development, the U.S. has provided technical assistance to help the ROK create a more favorable private investment climate and to attract increased amounts of capital. With the help of U.S. advisors and training supplied under an AID project, entitled Private Investment Promotion, the ROKG has established some basic policies, laws, and regulations to promote foreign private investment in Korea. The ROKG's Office of Investment Promotion (OIP) was set up on the advice of USAID advisors and now serves as a focal point for administering the Korean foreign investment program. Because the objectives of this earlier AID project have now been largely accomplished, it has terminated, as planned, at the end of FY 1970.

While the above progress has been noteworthy, the ROK still needs further technical assistance in the fields of private investment promotion and private enterprise development in order to maintain the nation's progress. The Korean economy continually requires additional sources of capital to assist Korea's industry and private business sector. Unfortunately, domestic savings, especially from the private sector, are quite low and are not increasing at a rate sufficient to meet the ROK's investment demands. In addition, the nation's continued economic growth could be seriously threatened by the substantial debt service burden resulting from recent, heavy borrowings. While the ROKG is now taking some steps to counter this situation, by limiting the amount of new loans taken on and reducing the growth rate of GNP to a more manageable level, it is also apparent that Korea must attract more private direct equity investment, both foreign and domestic.

One means of obtaining this needed capital is through increased private foreign investment. While the ROK has already shown that it is capable of attracting some external investment, it has also become evident that numerous problems still exist. Korea's investment promotion activities are minimal. In recent years, the ROK has had increasing difficulty in successfully competing with other countries for the available foreign capital. In addition, the ROKG has encountered numerous problems in properly identifying priority areas of investment which are both good business ventures and also important contributions to the nation's development. Finally, the ROKG has had problems in analyzing investment proposals according to well-established criteria and in expediting the investment review process.

At the same time, the ROKG does not appear to fully understand what potential foreign investors are looking for in Korea and what services and information should be provided to them. Foreign businessmen often experience unnecessary problems and excessive ~~in communicating with~~ "red-tape" in communicating with OIP and the other ROKG offices which have responsibility for promoting or implementing investments. Also, government regulations regarding taxation, import controls, licensing, credit distribution, and other areas often serve as disincentives to increased foreign investment.

A further complicating factor in developing Korean private enterprise and in assisting the growth of the nation's economy is the scarcity of domestic capital available at reasonable costs. Local capital in Korea is still quite limited and borrowing on the unorganized money market is very expensive and hazardous. The low level of inexpensive domestic capital has not only adversely affected the growth of private industry and business but has also tended to lessen the ability of the ROK to attract and effectively use foreign investment. This situation has also encouraged a continuing preference for deficit over equity ~~financing~~ financing and an increase in demand for foreign loans. So far, organized finance in Korea has been able to provide only a small portion of the nation's increasing capital requirements. Therefore, what is now required is the development of a realistic and adequately regulated capital and money market to help make more capital available at reasonable costs in order to help private business and industry and to contribute to the nation's long-term economic development.

In addition, largely because capital is scarce in Korea and credit expensive, the ROKG has had to provide much of the domestic capital and is a partner in a number of industrial and business enterprises. The ROKG also controls many other domestic industries. This situation has severely hampered the development of private business and has also fostered the concentration of wealth in the hands of a very limited elite. It not only has an unhealthy effect on the nation's economy, but, in restricting the participatory base of the economy, also impedes social development. The ROKG has indicated that it wants to transfer to the private sector some of the industrial firms which the Government now owns and/or controls. A more developed capital market would greatly facilitate this transfer.

A further problem affecting the development of private enterprise in Korea is the use of traditional methods of management, production, and marketing in business and industry. With the exception of a few outstanding companies, Korean industry and business is still hampered by its use of inefficient business procedures and outdated production methods. The result has been the production of relatively low quality, high cost products which do not adequately meet the growing demands of a maturing domestic market and which retard Korea's important efforts to compete effectively in the international market.

Within the context of Korea's development program, it has become increasingly evident that a prerequisite for the nation's continued industrial and business development and economic progress is an increased use of the practical operating and management skills and the basic tools of day-to-day operations, without which no manufacturing or commercial unit can hope to survive in a competitive economy. These capabilities are inseparably identified with any effort to develop Korea's overall economy, to spur the growth of private industry, and to achieve international acceptance of Korean-made products. Some U.S. technical assistance has already been directed towards these areas, particularly to the Korea Productivity Center, with moderate success. However, because of its vital importance to the development of the Korean economy and private sector, further assistance is required, especially after FY 1971 when the Industrial Development Project terminates.

In recognition of the above technical assistance requirements, the ROKG has requested additional aid from the U.S. The USAID has responded by agreeing to request approval for a project to provide advisory services, training and limited commodities for private enterprise development over the course of the next five years.

C. Strategy

The U.S. strategy in this project is to encourage the growth and development of private enterprise in Korea in order to accelerate the nation's continued economic growth and to foster the social and political benefits that can accrue from such development. Although it has been forced to work under severe economic and political handicaps, the private sector in Korea has been able to provide much of the dynamism behind Korea's recent growth. This project will demonstrate the U.S.'s continuing concern for private enterprise and will facilitate the further development of this important sector of the Korean economy.

At the same time, this project is intended to assist the BOK in maintaining its position as an attractive foreign investment area. An economy with a well developed private sector and not overly controlled *LL Control* by the Government is more attractive to private foreign investment, including U.S. investment. In addition, a country that has a healthy outlook towards foreign investment with smoothly operating investment procedures has a greater chance of obtaining increased amounts of capital for the nation's development program.

In helping to attract foreign investment to Korea under this project, *from* increased emphasis will be placed upon improved procedures for and the inducement of private equity investment, in order to stay within the financial guidelines prescribed by the International Monetary Fund and numerous creditor nations. In this way Korea's economy will be assisted by being better able to stay on a sound financial footing and by maintaining a better international credit rating. The end result should be increased equity investment in Korea's development.

Still another part of the U.S. strategy assisted in part by this project is to help introduce into Korea modern financial and business ideas and practices, especially in the private sector. As Korea enters the modern business era, it must have up-to-date skills and concepts in order to cope successfully with new and complex problems of business and finance. By utilizing more modern practices it is anticipated that Korea's private industrial and commercial sector will be able to produce more and better quality goods for domestic consumption and to increase the nation's exports. In addition, the expansion and improvement of the money/capital market system is intended not only to assist the development of the private sector, but also to help provide more capital for Korean industry and business and thereby contribute to the overall growth of the nation's economy.

This project will be carefully coordinated by the Mission with other U.S. assistance projects as well as with any aid which may be supplied in the future by other donor nations, international organizations, and private associations.

D. Planned Targets, Results and Output

This project is designed to achieve the following objectives:

- a) assist the OIP to identify, evaluate and develop ^{private} investment opportunities in priority areas where private enterprise would be most conducive to ROK development (by end of FY 1971 and continuing);
- b) help the ROKG intensify private investment promotion operations so as to attract increased amounts of private foreign capital substantially beyond present levels (by end of FY 1971 and continuing);
- c) establish and improve standard procedures for the ROKG's prompt, effective analysis and evaluation of foreign investment proposals (by end of FY 1971);
- d) assist the ROKG in providing suitable follow-up assistance to private foreign investors in order to facilitate the implementation of investment projects and also attract additional investments (by end of FY 1971 and continuing);
- e) urge the ROKG to assume a more modest role in business and to adopt fiscal, tax and trade policies which would make it less competitive with and more helpful to private enterprise (by FY 1975);
- f) assist the Ministry of Finance (MOF) and private business in setting up a commercial paper market (by end of FY 1971);
- g) advise the MOF on ways of increasing the supply of and demand for securities and assist in improving the methods of trading these securities (by end of FY 1972);
- h) provide continuing advisory services to private business organizations on improved business practices so as to further help the growth of Korea's private sector (by FY 1971 and continuing); and
- i) advise the Korean Productivity Center about ways to further improve the quality of its consulting services to Korean private business (FY 1972 and continuing)

E. Course of Action

The USAID proposes to achieve the aforementioned targets through the provision of technical advice, training, and limited commodities. Where appropriate the USAID may utilize AID's Feasibility Study Development Loan (489-H-030) and the pre-investment survey program in connection with this project. This technical assistance project will also be carefully coordinated with the programs of other organizations, such as the International Executive Service Corps (IESC). The ROKG, Korean financial institutions, and private Korean organizations will make comparable contributions as well.

This project will finance the services of up to two direct-hire technicians. One advisor, a specialist in finance and investment, will assist the appropriate ROKG offices on investment review and analysis and private enterprise development. A second advisor, a specialist in international trade and investment, will help advise the ROKG on increased investment promotion and policies and administrative procedures to facilitate the flow of investments into Korea. These advisors will also make a survey of present foreign investors in Korea to help determine what problems exist in order to recommend needed changes in the ROKG's foreign investment promotion activities.

The above USAID advisors will also administer AID's Specific Risk Guaranty Program.

In addition, a business and industrial plant operations specialist, now funded under the Industrial Development Project which terminates at the end of FY 1971, will work with this new project to help promote Korea's private sector. This advisor will help private firms in improving their operations and assist in promoting joint ventures and technical and trade agreements with foreign private firms.

This project will fund the short-term services of various specialists, mainly in money and capital markets. These advisors will assist the Koreans in implementing programs to help provide more credit to private business, to reduce undue reliance on the unorganized money markets, and to strengthen the capital market structure and operations. During FY 1971, a banking and financial specialist, funded under the Technical Support Project, will help provide advisory services to the ROKG on money and capital markets.

It is also proposed that this project finance training and observation tours in the U. S. and third countries for up to 15 Korean participants per year. These participants, selected especially from the private sector, will see first hand what private investment promotion work is being done by other countries, confer with U. S. business associations concerning U. S. investment in Korea, observe money and capital market operations in the U. S., and receive training in American business know-how and industrial practices for adaptation in Korea. It is also anticipated that some funds under this project may be used to purchase library materials, textbooks, and professional journals for Korean organizations. ✓

Upon termination of this Private Enterprise Development Project, it is expected that the ROKG will have achieved significantly more expertise in private enterprise promotion and investment analysis. It is also anticipated that Korea's private business sector and money and capital markets will have been greatly assisted by the efforts made under this project.

Further details on this project will be set forth in Project Implementation Plans or in any revisions to this PROP.

AGENCY FOR INTERNATIONAL DEVELOPMENT (A.I.D.)

PROJECT AUTHORIZATION

Proj. 4890677
PN-

4-577	Republic of Korea	4. AUTHORIZATION NUMBER 0079
		5. AUTHORIZATION DATE 11/10/70
		6. PROPOSED DATE 8/24/70

a. Estimated Duration of Physical Work
After Last Year of Funding (in Months): 12

FUNDING BY FISCAL YEAR (in U.S. \$ or \$ equivalent)	DOLLARS		P.L. 480	LOCAL CURRENCY Exchange Rate: \$1 =				
	GRANT	LOAN		CCC + FREIGHT	U.S. OWNED		HOST COUNTRY	
					GRANT	LOAN	JOINTLY PROGRAMMED	OTHER
Initial through								
Fiscal FY 70	--						--	
Operative FY 71	01						12	
Budget FY 72	15						21	
Budget FY 73							12	
Budget FY 74	135						16	
Budget FY 75	22						15	
Total FY's								
							37	

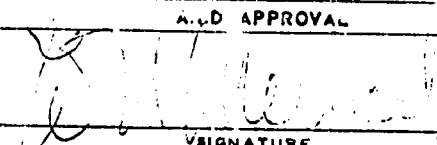
11. SPECIAL FUNDING AND RECOMMENDATIONS FOR IMPLEMENTATION, AND LIST KINDS AND QUANTITIES

12. CONDITIONS OF APPROVAL OF PROJECT

11. Approved in substance for the life of the project described in the PROP, subject to the conditions stated in Block 10 above, and the availability of funds. Detailed planning with the country and drafting of implementation documents is authorized.

This authorization is contingent upon the self-help and other conditions listed in the PROP or attached thereto.

This authorization will be reviewed periodically to determine the objectives, scope and nature of the project and of the magnitude and scheduling of any inputs or outputs derived so as to warrant submission of a new or revised PROP.

AND APPROVAL	CLEARANCES	DATE
 SIGNATURE AA/East Asia TITLE	EA/NEAP:CSBell	10/20/70
	EA/NEAP:CTShook	10/20/70
	EA/CDF:JMcCabe	10/20/70
	EA/DP:CHBregger	11/9/70